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TO: R. Mikulay/T. McCarthy DATE: January 23, 1991

FROM: Louis Suwarna

SUBJECT: "Frequent Buyers Plan"

Background

We are currently exploring a new price value idea under the trademark Fortune. In addition to positioning it at a generic price, Fortune has a unique selling proposition in that it rewards loyal consumers with high value gift items. Tentatively, we call this program the "Frequent Buyers Plan". As the name suggests, it is the counterpart to the airline's frequent flyer programs.

We think that this is a big idea, simply because today's margins are such that we can offer consumers very attractive gift items. But more importantly, the Fortune idea works very different than current branded generic brands. Rather than using coupons as the primary marketing "weapon", Fortune is designed to build consumer loyalty.

Obviously, Fortune's market potential is very much dependent on how appealing these gift items are. To determine this, we have used Cambridge budget as our benchmark. For 1991, Cambridge coupon budget is equal to approximately $2.00 for every carton that we expect to sell this year. In the case of Fortune, we have allocated $2.50 per carton for a gift program. At a consumption level of one carton per week, loyal consumers could receive after only one year a gift item that cost us $130.00. However, the perceived value could be as high as $150.00, as we would buy these items at wholesale prices.

As mentioned before, one significant advantage of the "Frequent Buyers Plan" is its potential to build consumer loyalty. Therefore, this program could also be the solution for some of our full margin brands that are more sensitive to price value. More importantly, it is an offensive tool that can expand the franchise as the "Frequent Buyers Plan" would appeal to other full margin smokers.

The purpose of this memo is to put forward our thoughts for your consideration and comments. I've also attached all the correspondence on Fortune to bring you up to date.

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A) Price Value

As we see it, Fortune is a new price value brand that could be more profitable in the long run on a per thousand basis than Cambridge. This is based on the assumption that Fortune will be able to maintain its "gift value" of $2.50/carton for some time, whereas Cambridge will likely have to continue its yearly coupon value increases to keep pace with Doral. Note also that Fortune requires far less sales force support than Cambridge as the brand will not be couponed.

The downside of another price value initiative seems to be obvious that it is a further erosion of PM USA 's profitability. After all, there is a tremendous disparity of the net marginal contribution between, let's say, B&H at approximately $30.00/1,000 vs. Fortune at approximately $7.00 - $8.00/1,000 (estimated for Year 2).

In spite of this, we are recommending to continue to develop Fortune as a fall back position.

One scenario that makes sense for Fortune is the possible situation where Cambridge could not meet its five year objectives of 4.3% share and a net marginal contribution of approximately $20.00/1,000 by 1995.

Another consideration would be the strategic advantage of two brands fighting Doral as opposed to one. Having two brands with a combined share of 4.3% would allow us to cut back Cambridge couponing, thus making the brand more profitable. Furthermore, the type of Cambridge smokers that we'll lose under this scenario would be the "every day low price smokers". These are the type of smokers that we only want on a need to basis. Some of these smokers could be captured by Bristol.

There is however, one overriding concern from a corporate point of view to launch Fortune. Fortune, being both a price and "value" brand could very well accelerate the cannibalization from our full margin brands.

B) Full Margin

We have not done an analysis to determine the profitability of a full margin brand with the frequent buyers plan. Obviously, from a profitability point of view, this makes sense only if the program can grow the franchise to offset the $10.00 - $12.00 loss in marginal contribution.

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I recommend that we should do a profitability analysis using various scenarios for future considerations. Worsening economic conditions coupled with higher cigarette prices could only accelerate the trend to price value. Some of our full margin brands will be faced with increased couponing to a point where it could make more sense to consider the frequent buyers plan.

The brand that we are recommending in the short term is Benson & Hedges KS. We ought to consider this for two reasons. One is simply as an insurance to make sure that Benson & Hedges KS reaches it's share of objective of 1.5%. The second reason is to build a franchise that is less sensitive to price value. Because of the program's ability to deliver high value gift items, the program can be executed with a high degree of quality image that is compatible and in fact, could reinforce the quality image of Benson & Hedges. Think of it as a "yuppie" catalog, if you will.

To maximize the program's appeal, the choice of gifts would include big ticket items, let's say a 26" color TV. Also, these big ticket items will entice smokers to pool their credits. For example, a family of two or more smokers could pool their credits enabling them to obtain the color TV as soon as, let's say a year depending on the number of participants.

As far as Benson & Hedges KS's profitability is concerned (see attached copy), the net marginal contribution would be approximately $12.00/1,000 in its first year, increasing to approximately $22.00/1,000 in the third year. This is based on a gift budget of $2.50/per carton. I should caution that this is a rough analysis. You may want to consider different marketing expenditures.

cc: E. Butson
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